

Members

Rep. B. Patrick Bauer, Chairperson
Rep. Vern Tincher
Rep. Lawrence Buell
Sen. Lawrence Borst
Sen. Vi Simpson



COMMISSION ON STATE TAX AND FINANCING POLICY

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Authority: IC 2-5-3-2

MEETING MINUTES¹

Meeting Date: October 4, 2000
Meeting Time: 3:30 P.M.
Meeting Place: State House, 200 W. Washington
St., Room 404
Meeting City: Indianapolis, Indiana
Meeting Number: 2

Members Present: Rep. B. Patrick Bauer, Chairperson; Rep. Vern Tincher; Rep. Lawrence Buell; Sen. Lawrence Borst; Sen. Vi Simpson.

Members Absent: None.

Representative B. Patrick Bauer, chair of the Commission, called the meeting to order at 3:30 p.m.

I. Taxation of Electronic Commerce

Representative Bauer then recognized Senator Lawrence Borst for comments concerning the taxation of electronic commerce. Senator Borst distributed a packet of information to members of the Commission. (See Exhibit A, GAO Report concerning sales tax and BNA E-commerce Tax Reports from 8/21/00 and 9/18/00).

Senator Borst commented that the National Conference of State Legislatures and other organizations are continuing their work on the "sales tax simplification" project, and that they are trying to convince retailers to participate in the project. He stated that he hoped

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.ai.org/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

model legislation that would allow Indiana to participate in the project would be introduced in the upcoming legislative session.

II. Renaissance Zones

Commission attorney Ross Hooten then presented the Commission with information comparing Michigan's Renaissance Zones, Pennsylvania's Keystone Opportunity Zones, and Indiana's Enterprise Zones. (See Exhibit B.) He stated that Michigan enacted its renaissance zone law in 1997 in order to attract jobs to areas that have struggling economies. Mr. Hooten explained that businesses located in and conducting business activity in a renaissance zone pay no real or personal property taxes, no "single business tax," and no state or local personal income taxes. He noted that the renaissance zone law allows for the establishment of "sub-zones."

Mr. Hooten stated that there are 20 renaissance zones in Michigan (10 urban, seven rural, and three former military installations), and he said Michigan claims that the zones have helped in adding over \$330 million in new investments.

Mr. Hooten stated that Pennsylvania's keystone opportunity zone program began in 1999. He explained that these zones are designated by local communities and approved by the state. Under the program, binding ordinances and resolutions were passed granting the waiver, abatement, or exemption of various state and local taxes, including real and personal property taxes, business income taxes, state personal income tax, local "earned income" tax, sales and uses taxes, local business occupancy tax, and local business privilege tax.

Mr. Hooten then briefly described Indiana's enterprise zone program, noting that the program was established in 1983 and that there are 21 zones. He explained that the enterprise zone program is governed by the Indiana State Enterprise Zone Board. Mr. Hooten next listed the tax incentives available under the enterprise zone program: (1) inventory tax credits; (2) a gross income tax exemption for zone businesses on increases in receipts from zone operations; (3) a state income tax credit for the purchase of an ownership interest in a zone business; (4) a loan-interest tax credit for lenders; (5) a state income tax credit based on wages paid to qualified zone employees; and (6) an income tax deduction for persons employed in a zone.

III. Taxation of Federal Employees' Retirement Benefits

Commission attorney Ed Gohmann then provided the Commission with information from the National Conference of State Legislatures and the National Association of Retired Federal Employees (NARFE) showing the state income tax treatment of various types of retirement income. (See Exhibit C.)

Mr. Gohmann explained that Indiana does not tax Social Security retirement benefits or federal Railroad Retirement Board benefits. These benefits, to the extent they are included in federal adjusted gross income and therefore included in Indiana's income tax base, are deductible under IC 6-3-1-3.5. Indiana provides a partial exemption for federal civil service annuity income. Under IC 6-3-2-3.7, a taxpayer who is at least age 62 is entitled to an income tax deduction equal to the difference between: (1) the first \$2,000 received from a federal civil service annuity during the year; minus (2) the total amount of Social Security benefits and Railroad Retirement benefits received during the year. Indiana also provides a partial exemption for military retirement income. Under IC 6-3-2-4 a taxpayer who is at least age 60 is entitled to an income tax deduction for the first \$2,000 of military retirement income. Mr. Gohmann also noted that Indiana does not provide any exemption for state

and local public employees' retirement income.

Ms. Diane Powers, fiscal analyst for the Commission, provided information on the fiscal impact of exempting various types of pension income from the state income tax. (See Exhibit D.) According to Ms. Powers' memorandum, a complete exemption of federal civil service annuity income from state income taxation would result in a revenue loss of approximately \$20 million for tax year 2001, and a complete exemption of military retirement income would result in a revenue loss of approximately \$9 million for tax year 2001.

Representative Bauer then recognized Mr. Claude Ferguson of Bedford, the Legislative Chairman of the Indiana Federation of NARFE. Mr. Ferguson stated that as a retired federal employee he must pay more Indiana income tax than those who chose to work in private employment in positions covered by Social Security. He said that he was asking for equity in the way that retired federal civil servants are taxed, and he cited a bill currently introduced in the United States Congress. (See Exhibit E, Mr. Ferguson's written testimony and exhibits.)

Mr. Frank Tester of Muncie was then recognized by Representative Bauer. Mr. Tester stated that he was speaking on behalf of Mr. Paul Johnson, President of the Indiana Chapters of NARFE. Mr. Tester testified that the discrimination in the state income taxation of retired federal employees has caused many of those federal retirees to move out of Indiana. He stated that federal retirees want to be treated the same as other retirees for tax purposes. (See Exhibit F, Mr. Tester's written testimony and exhibits.)

Representative Bauer recognized Mr. David Webb of Bunker Hill. Mr. Webb explained that he had retired from the military, but under the state military income deduction statute he could not claim the \$2,000 deduction for military retirement income until he reached age 60. Mr. Webb stated that the state discriminates against military retirees by not exempting the total amount of their retirement income. He also said that the state should refund the tax imposed on the military retirement income of those persons who have been unable to claim the military retirement income deduction because they were not yet age 60. In addition, Mr. Webb questioned why retirement benefits under the federal Railroad Retirement System are exempt from state income tax while military retirement income is not exempted.

Mr. Paul Severance, Executive Director of United Senior Action, stated that the organization supports the efforts to eliminate the unfair treatment of civil service and military retirement income. He said that all retirees should be eligible for the same deduction, regardless of the source of their retirement income. (See Exhibit G.)

Mr. Richard Wake of Boone County noted that as a retired federal employee, his retirement benefits are taxed, while those of his brother, who was covered by Social Security, are not taxed. A representative of the Paralyzed Veterans of Indiana testified that he agreed with Mr. Severance's comments concerning the tax discrimination against retired veterans in Indiana.

Representative Bauer then recognized Ms. Grace Wolf of Avoca. Ms. Wolf stated that she was requesting equal treatment under Indiana income tax law for all retired citizens. Ms. Wolf explained that she is a survivor of a federal civil service annuitant, and that Indiana law does not allow survivor annuitants to claim even the limited \$2,000 deduction for civil service annuitants. (See Exhibit H, Ms. Wolf's written testimony and exhibits.)

Mr. Ray Brown of Elberfield testified concerning the out-migration of retired federal employees who leave Indiana because of state tax concerns. He commented that the out-migration of retired federal employees is having a negative impact on Indiana's tax receipts and on the state's economy. Mr. Brown noted that when he retired from the Federal Aviation Administration, four co-workers who retired at the same time moved out of Indiana. He stated that Michigan, Illinois, and Kentucky have larger exemptions for federal retirement income. He cited a newspaper article discussing an Atlas Van Lines report showing that Indiana was one of fourteen states where more households shipped their belongings out of state than into the state. (See Exhibit I, Mr. Brown's written testimony and exhibits.)

Representative Bauer then recognized Ms. Joseph Ziegler of Bloomington. Mr. Ziegler stated that he supports the concept of treating all retired persons in Indiana equally under state tax laws, regardless of who employed those persons during their working years. He said that Social Security benefits receive a much more favorable treatment under Indiana tax law than federal civil service annuity income does. (See Exhibit J, Mr. Brown's written testimony and exhibits.)

Written testimony was provided to the Commission by Phillis Hurd (Exhibit K) and Allen Lauer, Sr. (Exhibit L).

Senator Tom Weatherwax testified that during the 1999 interim, the Pension Management Oversight Commission heard testimony on the issue of taxation of federal employees' pensions. He explained that the Pension Management Oversight Commission ultimately decided that the issue was a taxation issue, rather than a pension issue, and it referred the issue to the Commission on State Tax and Financing Policy.

Senator Weatherwax also noted that the Commission on Military and Veterans Affairs had recently recommended legislation to increase the \$2,000 state income tax deduction for military income (including retirement income) to \$6,000.

Senator Borst questioned whether the state should tax federal employees' retirement income differently than the federal government treats that income.

(IV) CAGIT \ COIT Distributions Based on Maximum Property Tax Levies

Mr. Bob Sigalow, fiscal analyst for the Commission, provided the Commission with information showing: (1) the actual 2000 certified share distributions of county adjusted gross income tax (CAGIT) and county option income tax (COIT); and (2) the distribution that would have been made if the distribution were based on units' maximum property tax levies rather than actual property tax levies. (See Exhibit M.)

Mr. Jeff Spalding, fiscal analyst for the House Republican Caucus, pointed out that under the existing law, CAGIT and COIT distributions to units of local government are based on the actual property tax levies collected by those units. Under this distribution formula, a local unit that decides to impose property taxes in an amount less than its maximum levy would not receive as much CAGIT or COIT revenue as it would if it imposed its maximum levy.

(V) Property Tax Exemptions for Nonprofits

Representative Bauer then recognized Mr. Hooten, attorney for the Commission, for a brief discussion of: (1) the property tax exemptions for property used for religious, educational,

or charitable purposes; and (2) recent court decisions addressing property tax exemptions.

Mr. Hooten began by noting that the statutes allowing property tax exemptions for property used for religious, educational, or charitable purposes do not apply to property owned by the state universities, and that state university property is governed by the statute applicable to property owned by the state of Indiana generally. He explained that property owned by the state of Indiana is exempt from property taxation under IC 6-1.1-10-2, which provides that:

"Sec. 2. Except as otherwise provided by law, the property owned by this state, a state agency, or the bureau of motor vehicles commission is exempt from property taxation."

Mr. Hooten pointed out that for purposes of this property tax exemption statute, the term "state agency" is defined to include a state college or university.

Mr. Hooten next explained that IC 6-1.1-10-16 provides an exemption for property used for religious, educational, or charitable purposes generally. He said that the key portion of IC 6-1.1-10-16 provides that:

"(a) All or part of a building is exempt from property taxation if it is owned, occupied, and used by a person for educational, literary, scientific, religious, or charitable purposes".

He explained that recent court cases have focused on the use of property and questions of ownership. When determining whether a person's property is used for "educational, literary, scientific, religious, or charitable purposes" the courts ask whether the property's use is "incidental and necessary or reasonably necessary" to the person's educational, literary, scientific, religious, or charitable purpose.

Mr. Hooten then briefly described the following Indiana Tax Court decisions:

In Alte Salems Kirche, the Tax Court rejected the State Tax Board's assertions that the Posey County church's provision of facilities to other organizations or groups for meetings or gatherings at no cost does not constitute a charitable act and that the church had failed to show that the property was used predominantly for a religious, educational, or charitable purpose. The Tax Court considered the use of the church for that charitable action along with the religious use of the property, and it determined that the church was predominantly used for religious and charitable uses.

In New Castle Moose, the Tax Court reviewed the various charitable endeavors undertaken by the Moose Lodge. The Tax Court rejected the State Tax Board's reliance upon the amount of the lodge's gross income donated to charity. The State Tax Board argued that the lodge's donation of four percent of its gross income was insufficient to qualify for a property tax exemption. The Tax Court disagreed. According to the Tax Court, the analysis does not "turn on the percentage of its gross income used for charitable, educational, or other benevolent purposes (citation omitted). Instead, a building's exempt status turns on whether the property is predominantly used for the above mentioned purposes more than 50% of the time."

In Plainfield Elks, the Tax Court also reviewed a lodge's monetary and in-kind contributions to charity. The State Tax Board had found the combination insufficient to qualify for a property tax exemption. Among the factors cited by the Board were the small percentage of the lodge's gross income contributed to charity; the fact that some of the Elks' activities were social, and the fact that the Elks had realized a small profit on the

operation of the golf course located on the property. The Tax Court rejected the invitation to create a bright line test based upon the percentage of gross income donated to charity. The Tax Court held that property was predominantly, but not solely used for charitable purposes, and it remanded the case to the Board to determine the percentage of the exemption applicable to the property. (See Exhibit N.)

Representative Bauer then recognized Mr. Sigalow, fiscal analyst for the Commission. Mr. Sigalow provided the Commission with information listing the amount of reported exempt property in each county. The information showed the gross assessed value (before exemptions and deductions) and the reported exemptions in each county. Mr. Sigalow explained that the exemptions were reported by county auditors on the auditors' abstracts. He also pointed out that it is possible that some exempt property may not be assessed and therefore would not be shown as exempt property. He also noted that the exempt property amounts reported by county auditors should not include any non-taxable property, such as government-owned property. (See Exhibit O.)

Representative Bauer and Senator Borst both commented on the fact that more than 20% of the assessable land for Vigo County and Gibson County was shown as exempt from property taxes, and they asked staff to research this issue.

(VI) Examples of Property Tax Relief Programs

Mr. Gohmann then provided the Commission with: (1) a memorandum describing examples of property tax relief programs that have been enacted by various states to alleviate property tax burdens; and (2) information providing a state-by-state description of circuitbreakers and homestead credits and exemptions. (See Exhibit P.) Mr. Gohmann briefly described a number of approaches taken by states in providing property tax relief, including homestead exemptions or deductions; property tax credits and circuitbreakers; property tax deferrals; credits and exemptions for agricultural property; acquisition value assessments; assessed value freezes; caps on percentage increases of property values from reassessment; classification of property for assessment purposes; refunds or rebates; and phasing-in of new assessed values.

He stated that according to a 1998 report, 28 states and the District of Columbia provided homestead exemptions or deductions. In some states, all homeowners are eligible for the exemption, while in other states, the exemption is allowed for only a certain type of homeowner, such as the elderly or disabled. Mr. Gohmann gave a number of examples of homestead exemptions from other states, but he noted that it is difficult to make comparisons of the exemptions established by various states, because the assessment rate applied to actual value varies on a state-by-state basis. Mr. Gohmann stated that "homestead credits" are much less common throughout the United States than homestead exemptions or deductions.

Mr. Gohmann also briefly described a number of property tax deferral programs, which allow elderly homeowners to defer payment of some or all property tax liability until death or the sale of his or her home. Twenty-two states and the District of Columbia have some type of deferral program. Mr. Gohmann described California's "property tax postponement program" under which a qualified homeowner (legally blind, disabled, or age 62 or older; annual household income must be \$24,000 or less) can defer payment of all or part of his or her property taxes on a house, condominium, or mobile home. This deferred payment is a lien on the property and becomes due upon sale, change of residence, or death.

There being no further questions or testimony, Representative Bauer adjourned the meeting at approximately 5:30 p.m.